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No. 87-1284

IN THE

Supreme Court of the United States

OCTOBER TERM, 1987

TRANS WORLD AIRLINES, INC.;
TRANSWORLD CORPORATION,

Petitioners,

—v.—

JOEL KRONFELD,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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QUESTIONS PRESENTED

1. Whether an issuer can be held liable under the federal securities laws for failing to disclose the existence of an unfinished study of numerous corporate options or the uncertain possibility that one such option might be the subject of future corporate action, prior to any consideration of, or action upon, either the study or any of the proposed options by the issuer's decisionmakers?

2. Whether an especially strict standard applies to motions for summary judgment involving the issue of materiality in federal securities actions, thereby effectively eliminating the use of summary judgment in such actions?

PARTIES TO THE PROCEEDING

The parties to this proceeding are:

1. Petitioner Trans World Airlines.*

2. Petitioner Transworld Corporation.**

3. Respondent Joel Kronfeld, on behalf of a class of purchasers of cumulative convertible preferred stock of Trans World Airlines.

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* The following are or may be considered parent companies, subsidiaries or affiliates of TWA: AERO Limited Partnership; Mandrake Partners Limited Partnership; O'Riole Corp.; ACF Industries Incorporated; Heron Industries Plan, Inc.; Icahn Capital Corporation; Icahn Holding Corporation; Carl C. Icahn; Excalibur Partners (General Partnership); GNU Corp.; Unicorn Associates Corporation; and Ferris Wheel Associates Limited Partnership.

** Following the liquidation of Transworld Corporation on December 30, 1986, TW Services, Inc. succeeded to the bulk of the businesses then conducted by Transworld Corporation. An indirect subsidiary of TW Services, Inc. is the general partner in Winchell's Donut Houses L.P., a Delaware limited partnership.

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Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

Transworld Corporation ("TWC") and Trans World Airlines, Inc. ("TWA") respectfully petition for a writ of certiorari to review the judgment of the United States Court of Appeals for the Second Circuit, entered in this case on November 2, 1987, which reversed the decision of the United States District Court for the Southern District of New York (Weinfeld, J.) granting summary judgment to defendants.

OPINIONS BELOW

The majority and dissenting opinions of the court of appeals are reported at 832 F.2d 726 (2d Cir. 1987). Upon the denial of the petition for rehearing, the majority issued an order amending the opinion which is unreported. The opinion of the district court granting summary judgment dismissing the complaint is reported at 631 F. Supp. 1259 (S.D.N.Y. 1986). These opinions are reprinted in the Appendix to this Petition.[1]

1. References to "_____a" are to pages of the Appendix.

JURISDICTION

The judgment of the court of appeals reversing the judgment of the district court was entered on November 2, 1987. A timely petition for rehearing and a suggestion for rehearing *in banc* were denied on December 28, 1987 and December 30, 1987, respectively. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

STATUTES AND RULES INVOLVED

The statutes and rules involved in this proceeding are Section 11 of the Securities Act of 1933, 15 U.S.C. § 77k (1982), Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b) (1982), and Rule 10b-5, 17 C.F.R. § 240.10b-5 (1987). These statutes and the rule are reprinted in relevant part in the Appendix.

STATEMENT OF THE CASE

In this case, a divided panel of the Second Circuit rejected the holding of the district court that the federal securities laws do not require disclosure of "mere contingencies long in advance of the first consideration of the question by those responsible for decision." (45a.) Instead, the panel ruled that issuers of securities can be held liable in damages if they do not disclose in a prospectus *possible* future corporate action and the existence of unfinished studies which include such action among other possible corporate options, even though they neither have been considered, nor acted upon, by any corporate decisionmaker. This radical change in the law cannot be reconciled with *TSC Industries, Inc. v. Northway*, 426 U.S. 438 (1976), is at odds with numerous appellate holdings that have concluded that "possibilities" need not be disclosed,[2] and

2. *E.g., SEC v. Mize*, 615 F.2d 1046, 1055 (5th Cir.) (disclosure must occur "[w]here the occurrence of a proposed course of action has

is inconsistent with recent cases holding preliminary merger negotiations immaterial as a matter of law.[3]

In addition to imposing a novel standard for corporate disclosure, the majority also concluded that an especially strict standard applies to motions for summary judgment on the issue of materiality under the securities laws which conflicts with the Court's recent decisions in *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 106 S. Ct. 2505 (1986); *Celotex Corp. v. Catrett*, 477 U.S. 317, 106 S. Ct. 2548 (1986); and *Matsushita Electric Industrial Co. v. Zenith Radio Corp.*, 475 U.S. 574 (1986).

If upheld, the decision below (a) would impose an extraordinary burden of premature disclosure on issuers and would bury investors under an avalanche of information about mere corporate possibilities, and (b) would effectively eliminate the use of summary judgment on the issue of materiality in litigations involving the federal securities laws.

The Parties

Petitioner TWA has, for many years, operated one of the nation's largest airlines. On July 29, 1983, TWA made a public offering of cumulative convertible preferred stock (the "Offering"). The prospectus and the registration statement issued in connection with the Offering are the subject of this action.

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reached a stage of *probability* rather than mere possibility"), *cert. denied*, 449 U.S. 901 (1980) (emphasis added); *Missouri Portland Cement Co. v. Cargill, Inc.*, 498 F.2d 851, 872 (2d Cir.) (tender offeror had no duty to disclose a plan to expand target's business, although it had commissioned such a plan from an outside consultant, since there was no evidence that any such plan in fact had been developed or adopted), *cert. denied*, 419 U.S. 883 (1974).

3. *E.g.*, *Flamm v. Eberstadt*, 814 F.2d 1169, 1178 (7th Cir.), *cert. denied*, 56 U.S.L.W. 3246 (October 6, 1987); *Reiss v. Pan Am. World Airways, Inc.*, 711 F.2d 11, 14 (2d Cir. 1983); *Staffin v. Greenberg*, 672 F.2d 1196, 1204-07 (3d Cir. 1982).

At the time of the Offering, petitioner TWC owned approximately 80% of TWA's common stock and had four other wholly-owned subsidiaries. Two months later, on September 28, 1983, TWC's Board of Directors announced that it had asked management to develop a plan for the possible separation or spinoff of TWA. A plan to spin off TWC's TWA stock to TWC's stockholders was subsequently presented to and approved by TWC's Board of Directors and shareholders and took effect on February 1, 1984.

Respondent Joel Kronfeld, who purchased 200 shares of TWA cumulative convertible preferred stock in the Offering, represents a class of persons who purchased such stock between July 29, 1983, the date the stock was issued, and September 27, 1983, the day before TWC made its announcement concerning a spinoff of TWA.

The Odyssey Proposal and Goldman Sachs Assignment

In April 1983, several months before the Offering, TWC's Board had recommended against, and its shareholders had rejected, a stockholder proposal by Odyssey Partners (the "Odyssey Proposal") to completely restructure TWC by selling or spinning off its five subsidiaries. (36a-38a.) TWC had retained Goldman, Sachs & Co. ("Goldman Sachs") to assist in responding to the Odyssey Proposal. TWC also asked Goldman Sachs to conduct an independent study of TWC's existing diversification strategy, as well as the other financial and structural alternatives available to the company, and to report its findings to the Board before August 31. (37a.)[4] Goldman Sachs' presentation to TWC's Board was originally scheduled for July 27. (A45, 38a.)[5] However, Goldman Sachs had made little progress by the end of June, and the presentation was

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4. TWC's retention of Goldman Sachs and Goldman Sachs' assignment was widely publicized in connection with the Odyssey proxy battle and was reported again after the stockholder vote. (6a-7a.)

5. References to "A_____" are to pages of the Joint Appendix filed in the court of appeals. The record has not been certified to the Court at this time, but will be done upon the Court's request.

rescheduled for September 6 (38a), since the Board did not meet in August. (A45.)

The Goldman Sachs Study

At the time of the Offering on July 29, Goldman Sachs had not completed its study and had reached no conclusions. Frank Salizzoni, TWC's chief financial officer and a director of both TWC and TWA, was in charge of monitoring Goldman Sachs' progress. He had reached the personal view that a separation of TWA might be desirable.[6] (41a.) But, TWC's Board had not yet even considered any of the numerous options in the still-uncompleted Goldman Sachs study, much less decided on a separation of TWA, or any other change in TWC's structure. (44a.) Indeed, unlike Salizzoni, TWC's president and Chairman, had not made any decision that a separation of TWA, or any other change, was desirable. (A39, A44.)

The Prospectus

The prospectus issued by TWA in connection with the Offering painted a grim picture of TWA's financial condition and prospects, setting forth the large losses it had experienced in the past and the reasons why these losses were expected to continue. (A109.) Purchasers were advised that TWA could not predict whether it would have sufficient cash in the future to pay dividends or redeem the convertible preferred stock, and that TWC had no obligation to make such payments or to make funds available to TWA. (A109.) Immediately before describing the existing financial relationships between TWA and TWC, the prospectus alerted investors that the financial support provided by TWC in the past might not continue:

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6. Handwritten notes written by a junior associate at Goldman Sachs during a meeting on July 7, 1983 with Salizzoni and members of his staff state: "goal-build liquidity in airline & cut cord w/TWC so they can walk away." These words were preceded by the contradictory statement: "TILL DEATH DO US PART." (41a.) Although plaintiff deposed all the meeting attendees, no one, including the author of the notes, recalled anyone ever making such statements. (A229.)

> There may in the future be other arrangements between TWA and [TWC] (or other of its subsidiaries). It is intended that the terms of these arrangements will be determined on an arms-length basis. There can be no assurance, however, that these terms will be favorable to TWA or that [TWC] will continue to provide TWA with the same level of support for TWA's financing and other needs as it has in the past. ((38a-39a) (footnote omitted).)

In addition, the section titled "CONTROL BY [TWC]" disclosed that TWC had reduced its holdings of TWA stock to approximately 80 percent only a few months earlier (A132), and had obtained consents from TWA's lenders to reduce further its holdings to 60 percent. It also specifically informed investors that TWC might in the future reduce its holdings still further, assuming the consents required from lenders and stockholders were obtained. (8a-9a.)

The Goldman Sachs September 6th Report to TWC's Board

When Goldman Sachs made its presentation to TWC's Board on September 6, it discussed advantages and disadvantages of seven structural and financial alternatives available to TWC, including maintaining the existing structure and corporate strategy,[7] and Goldman Sachs made no recommendation

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7. Goldman Sachs presented the following seven alternatives:

   (1) Liquidation;

   (2) Sale of TWC;

   (3) Partial liquidation, through the sale of TWA or other subsidiaries;

   (4) Additional sales of TWA shares to the public;

   (5) Sale of 20 percent of a "hospitality company," composed of non-airline subsidiaries;

   (6) Separation of TWC and TWA by a spinoff of the airline or a rights offering to TWA shareholders; and

   (7) Continuation of the holding company structure and maximizing operating returns under the existing diversification strategy. (9a.)

to the Board. (39a.) Immediately following the Goldman Sachs presentation, there was extensive discussion among TWC's directors of the alternative of separating the airline, with various directors voicing opposition, surprise and concern. (44a.) No decision on the merits of any alternative was reached at that time. Rather, the Board referred consideration of the Goldman Sachs report to its Finance Committee which met on two occasions over the next three weeks. (39a.) On September 27, the Finance Committee recommended that the Board develop a detailed program for a possible spinoff. This proposal was adopted by the Board on October 26, approved by the shareholders on December 28, and became effective on February 1, 1984. (39a.)

Prior Proceedings

Kronfeld's complaint alleged that the prospectus misled investors to purchase their stock in the belief that TWC would continue to support TWA financially (A9), by omitting to disclose that: (1) TWC was considering a plan to "spinoff" TWA (A9); (2) Goldman Sachs was studying structural and financial alternatives available to TWC (A14); and (3) "Goldman Sachs was preparing to recommend to [TWC] the spinoff of TWA." (A15.)[8]

Following completion of discovery, the district court granted summary judgment, holding that defendants could not be held liable for failing to disclose additional information, beyond that contained in the July 29 prospectus, regarding the relationship between TWC and TWA or the activities of Goldman Sachs. (43a.) In his opinion, Judge Weinfeld emphasized that:

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8. In responding to petitioners' summary judgment motion in the district court, respondent abandoned his claims with respect to the second and third claimed omissions, resting exclusively on the first: that TWC—the corporation—was considering "*a plan*" to spin off TWA. (A9.) On appeal, respondent again changed gears, claiming that "[w]hat should have been disclosed, however, were: (a) that defendants' chief financial officer and Goldman Sachs were studying the possibility of spinning off TWA; and (b) that a proposal in this regard would be presented to the Board in September." (Brief of plaintiff-appellant on appeal to the Second Circuit, dated June 24, 1986, at 32.)

— The Prospectus contained a number of statements advising investors that the existing relationship between TWC and TWA was "subject to significant change" (43a);

— As of July 29, 1983, TWC's Board of Directors had not considered, much less approved, a separation of TWA (44a);

— No plan or proposal to change the relationship between TWC and TWA had been presented to TWC's Board as of the date of the offering (44a);

— TWC's retention of Goldman Sachs to investigate alternative structures for TWC "had been extensively publicized by TWC" (45a); and

— Goldman Sachs' study "was directed toward the identification and analysis of *options* for consideration by TWC's Board", and had not even been completed as of July 29. ((44a) (emphasis in original).)

Although he observed that events occurring after July 29 are "not determinative of the question of which matters defendants had a duty to disclose on July 29" (44a), Judge Weinfeld also noted:

— On September 6, 1983, when Goldman Saehs ultimately presented the results of its study to TWC's Board, it outlined *seven* options for Board consideration and "put forward no recommendation as to any option" (39a, 44a);

— The reaction of TWC's Board to the initial presentation in September of the idea of separating TWA "included . . . substantial expressions of 'surprise, concern and opposition' " (44a); and

— After the Goldman Sachs presentation, TWC's Board referred the matter to its Finance Committee for further consideration; it was not until three weeks later that the Committee recommended that the Board

authorize development of a program to spinoff TWA. (39a, 44a.)

Judge Weinfeld concluded that the federal securities laws do not require disclosure of "mere contingencies long in advance of the first consideration of the question by those responsible for decision." (45a.)

In an opinion written by Judge Mahoney, a divided panel of the court of appeals reversed on the ground that the district court had applied the wrong legal standard. The Court did not find that there was any evidence in the record that, as of July 29, the study had been completed or presented to the Board, or that the Board had reached even a tentative (much less a final) decision on the spinoff or any other option in the study. Nevertheless, purporting to apply the balancing test set forth in *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833, 849 (2d Cir. 1968) (in banc), *cert. denied*, 394 U.S. 976 (1969) because the alleged omissions concerned a prospective event, the court of appeals held in its original opinion that a jury question was presented because the possibility of a TWA spinoff was "more than wholly remote." (24a.) When defendants moved for rehearing, arguing that the "wholly remote" standard of materiality conflicted with *Northway*, the court amended its opinion to recharacterize the spinoff as "a substantial *possibility*." ((33a) (emphasis added).) The court did not suggest, however, that there was any basis whatsoever for believing on July 29 that a spinoff was *probable* or even a substantial likelihood. In addition, the majority held that a particularly "strict standard" applies to motions for summary judgment on the issue of materiality, and, therefore, this case should be submitted to a jury. (23a.)

Judge Miner dissented, recognizing that the proper standard of materiality for prospective events must be based on *probability*, not possibility. (30a.) Because there was no way the undisputed evidence in the record could be viewed to permit a finding that a spinoff was probable, or more probable than the various other options under consideration, he concluded there

was no *genuine* issue of fact and summary judgment should have been granted. (30a-31a.) Furthermore, Judge Miner reviewed the disclosures made in the prospectus, finding:

> The information provided was full and complete, potential investors were cautioned adequately as to the problems facing the company, and there was no false representation of any kind. A jury should not be afforded the opportunity to speculate otherwise. (29a.)

REASONS FOR GRANTING THE WRIT

This petition should be granted because of the significant impact of the decision below on the disclosure obligations of all issuers of securities, on investors' abilities to make intelligent investment decisions, and on the application of summary judgment to securities litigation:

First, because this Court has not addressed specifically the proper standard of materiality for contingent events, the majority purported to apply the "probability/magnitude" balancing test set forth in *Texas Gulf Sulphur*, 401 F.2d at 849. Its holding that a "substantial possibility" of future corporate action not disclosed in a prospectus presents a jury question cannot be squared with *Northway* or *Texas Gulf Sulphur*, and the numerous holdings that have rejected the argument that "possibilities" need to be disclosed. *See* discussion *infra* pp. 15-16. In addition, because its holding is inconsistent with the numerous cases holding preliminary merger negotiations immaterial as a matter of law, the majority established two standards of materiality governing corporate disclosure of contingent events to distinguish this and other non-merger cases from merger case precedent: a "constructive immateriality" standard for mergers (21a) and a "substantial possibility" of occurrence standard for other, future events. (33a.) There is no principled basis for treating these contingencies differently. Indeed, the decision below would result in the anomalous rule of law that a corporation must disclose a *possible* future course

of action which has not yet even been considered by the Board of Directors, but need not disclose a *probable* future merger - which the Board has already considered and authorized management to attempt to negotiate.

Issuers are continually engaged in studying possible future corporate action—often very significant action—and properly so. The majority's decision creates a disclosure standard that would be incredibly burdensome, if not impossible, for issuers to meet. Issuers would need to disclose every unfinished study of "possible" future action and every alternative that is being studied, even if it has not yet been finalized, or presented for consideration or approved by the Board, or even if there is no Board or management consensus that it should be adopted.[9]

Moreover, issuers nationwide would face the risk of substantial liability whenever they failed to predict an event that later occurred, for it would be difficult indeed for an issuer to argue to a jury that there was not at least a "substantial possibility" that an event would occur, when it, in fact, did occur. Disclosure of "possibilities" would also severely impair a company's ability to compete and would chill creative and constructive identification, development and study of corporate alternatives to the detriment of the company and its stockholders.

The direct result of the Second Circuit's "possibility" standard would be to bury shareholders under endless carefully-phrased and essentially meaningless disclosures about "possible" future events. Material *facts*, which the securities laws require for the investors' and markets' information and informed decision-making, would be lost or their importance diminished by the welter of possibilities, studies and proposals

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9. Because the court of appeals' holding is not narrowly limited, studies regarding other significant future events affecting a corporation, such as new products, efforts to discover sources of raw materials, and new marketing or financing plans would also have to be disclosed. Moreover, the court's "possibility" disclosure obligation would not appear to be confined to issuers involved in public offerings, but would apply to all instances of corporate disclosure.

which would have to be publicized under the disclosure standard adopted by the Second Circuit.

This Court should settle the important question of the standard of materiality applicable to contingent events in a way that preserves the balance that *Northway* established between too much and too little disclosure: the "possibility" standard adopted by court of appeals must be rejected in favor of a uniform standard that requires corporate disclosure of contingencies only if their occurrence appears "probable." Mere studies of future options and alternatives should not have to be disclosed unless and until they have been presented to and have been the subject of some affirmative action by the corporate decision-maker.

Finally, the court of appeals' decision would sound the death knell for summary judgment in securities actions and represents an invitation to disappointed investors further to inundate the courts with such litigation. If all a shareholder must do to get to a jury is to show that an officer or outside advisor of a corporation has considered or been asked to study a "possible" course of action which was not disclosed at the time of a public offering, then the courthouse doors will be opened even wider than they presently are to shareholder suits. The decision below removes from the arsenal of the trial court the most effective weapon against baseless shareholder actions and undercuts this Court's efforts to revive summary judgment as a meaningful alternative to the full-scale trial of every case as enunciated in *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 106 S. Ct. 2505 (1986); *Celotex Corp. v. Catrett*, 477 U.S. 317, 106 S. Ct. 2548 (1986); and *Matsushita Electric Industrial Co. v. Zenith Radio Corp.*, 475 U.S. 574 (1986).

I. THE SECOND CIRCUIT'S "POSSIBILITY" STANDARD OF MATERIALITY FOR JUDGING THE DISCLOSURE OF CONTINGENT EVENTS IS INCONSISTENT WITH *NORTHWAY* AND CANNOT FEASIBLY BE MET BY ISSUERS.

In *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438 (1976), this Court stressed that the standard of materiality under the federal securities laws must maintain "the proper balance between the need to insure adequate disclosure and the need to avoid the adverse consequences of setting too low a threshold for civil liability." *Id.* at 449 n.10. *See also Mills v. Elec. Auto-Lite Co.*, 396 U.S. 375, 384 (1970). As the *Northway* Court cautioned:

> Some information is of such dubious significance that insistence on its disclosure may accomplish more harm than good. The potential liability for a Rule 14a-9 violation can be great indeed, and if the standard of materiality is unnecessarily low, not only may the corporation and its management be subjected to liability for insignificant omissions or misstatements, but also management's fear of exposing itself to substantial liability may cause it simply to bury the shareholders in an avalanche of trivial information—a result that is hardly conducive to informed decisionmaking. 426 U.S. at 448-49.

Accordingly, this Court rejected the definition of a material fact that the Seventh Circuit had adopted in *Northway*—"a fact which a reasonable shareholder *might* consider important"—as " 'too suggestive of mere possibility, however unlikely.' " *Id.* at 449 (quoting *Gerstle v. Gamble-Skogmo, Inc.*, 478 F.2d 1281, 1302 (2d Cir. 1973)). It adopted instead a standard based on probability, holding that "an omitted fact is material if there is a *substantial likelihood* that a reasonable shareholder *would* consider it important." 426 U.S. at 449. (emphasis added). "Put another way, there must be a *substantial likelihood* that disclosure of the omitted fact *would* have been viewed by the reasonable investor as having *significantly*

altered the 'total mix' of information made available." *Id.* (emphasis added). Here the Second Circuit created a standard of materiality with all of the vices of the "might" formulation which *Northway* rejected.[10]

Because this Court has not addressed specifically the proper standard of materiality for contingent events, the court of appeals looked to the "probability/magnitude" balancing test set forth in *Texas Gulf Sulphur*, 401 F.2d at 849.[11] Although the *Texas Gulf Sulphur* standard clearly speaks in terms of "probability" and the *Texas Gulf Sulphur* court specifically stated that "educated guesses" and "predictions" need not be disclosed, *Id.* at 848, the majority below reversed the district court and held that a jury could properly find that the *mere possibility of a spinoff* (and/or the fact that Goldman Sachs

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10. In essence, the Second Circuit's "possibility" standard represents the application to contingent events of the rejected "might" formulation. Indeed, in its original opinion, the Second Circuit explicitly relied on the "might" formulation, concluding its discussion of the appropriate legal standard to be applied in this case by quoting the following language from *Sonesta Int'l Hotels Corp. v. Wellington Assocs.*, 483 F.2d 247, 253 (2d Cir. 1973):

> " 'The test of materiality is not whether a possible consequence of the offer was contingent or hypothetical . . . but whether it was a factor that *might* be considered of some importance by a [target] stockholder in making his decision.' " ((17a) (emphasis added).)

Following petitioners' petition for rehearing, the Second Circuit amended its opinion to delete this language; however, the majority did not alter the analysis that flowed from its original language and citation. (32a.)

11. In connection with an insider trading claim, the court in *Texas Gulf Sulphur* stated that "material facts include . . . facts which affect the *probable* future of the company" and that an assessment of the materiality of facts relating to prospective events requires "a balancing of both the indicated *probability* that the event will occur and the anticipated magnitude of the event in light of the totality of the company activity." 401 F.2d at 849 (emphasis added).

was studying that and other possible alternatives for TWC) was material information that should have been disclosed.[12]

As construed by the court below, the "probability/magnitude" test would require issuers to disclose every alternative under study, at any level of the company or by any outside consultant, and every other possible event that would be of significance to the company if it were to occur. To say that this standard only requires disclosure of "substantial" possibilities is, as a practical matter, no limitation at all. Possibilities, as opposed to probabilities, are by definition not likely to occur. To attempt to distinguish between future courses of action that are only somewhat unlikely (and thus perhaps "substantial" possibilities) and those possibilities that are very unlikely, would be fruitless, if not metaphysical. The court below demonstrated just how ephemeral the distinction would be, first assessing the "possibility" of a spinoff here—not its "probability"—as "not wholly remote" and then, without any further review or explication of the facts, terming it as "substantial." But under the standard the court adopted, an issuer's exposure to potential ruinous civil liability would turn on precisely that distinction.

As Judge Miner recognized in his dissent, the proper standard of materiality for contingent events must be based on "probability," not "possibility." (30a.) Most decisions in the corporate disclosure context are in accord that the mere possibility of future corporate action is not material and need not be disclosed. *See, e.g., Sonesta Int'l Hotels Corp. v. Wellington Assocs.*, 483 F.2d 247, 251 (2d Cir. 1973) (a contingent event may be material "provided there appears to be a *reasonable*

12. The court of appeals implicitly acknowledged that there was no basis for believing a spinoff was probable—or more probable than any of the other alternatives—when the prospectus was issued. Initially, the court merely stated that a spinoff was "more than a wholly remote possibility." (24a.) By amendment on motion for rehearing, the court characterized it as a "substantial possibility." (33a.)

likelihood of its future occurrence") (emphasis added); *SEC v. Mize*, 615 F.2d 1046, 1055 (5th Cir.) (disclosure must occur "[w]here the occurrence of a proposed course of action has reached a stage of *probability* rather than mere possibility"), *cert. denied*, 449 U.S. 901 (1980) (emphasis added); *Arber v. Essex Wire Corp.*, 490 F.2d 414, 421 (6th Cir.) ("mere speculation [as to future corporate activity], however, does not provide any basis for Section 10(b) liability"), *cert. denied*, 419 U.S. 830 (1974); *Susquehanna Corp. v. Pan Am. Sulphur Company*, 423 F.2d 1075, 1085-86 (5th Cir. 1970) ("predictions of future behavior" are not material); *Hassig v. Pearson*, 565 F.2d 644, 649 (10th Cir. 1977) (possibilities regarding a potential sale of shares are not material).[13]

The court below also erroneously decided that recent cases holding preliminary merger negotiations immaterial as a matter of law have no relevance here. (21a-22a.) *See, e.g., Flamm v. Eberstadt*, 814 F.2d 1169, 1178 (7th Cir.), *cert. denied*, 56 U.S.L.W. 3246 (October 6, 1987); *Reiss v. Pan Am. World Airways, Inc.*, 711 F.2d 11, 14 (2d Cir. 1983); *Staffin v.*

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13. Similarly, courts have uniformly held that studies of such possibilities and the views of individual officers are, as a matter of law, not material. *Rodman v. Grant Found.*, 608 F.2d 64, 72 (2d Cir. 1979) (a director's speculative concern as to a future event is not a material fact); *Missouri Portland Cement Co. v. Cargill, Inc.*, 498 F.2d 851, 872 (2d Cir.) (tender offeror had no duty to disclose a plan to expand target's business, although it had commissioned such a plan from an outside consultant, since there was no evidence that any such plan in fact had been developed or adopted), *cert. denied*, 419 U.S. 883 (1974); *Electronic Specialty Co. v. Int'l Controls Corp.*, 409 F.2d 937, 951 (2d Cir. 1969) (president's personal desires do not constitute a material corporate plan); *Harnett v. Ryan Homes, Inc.*, 496 F.2d 832, 838 (3d Cir. 1974) (CEO's personal views are not material because they "must complete a circuitous course before becoming, if ever, actuality" and because if a corporation were required to disclose the musings of its officers, few transactions would avoid charges of securities law violations); *Feit v. Leasco Data Processing Equip. Corp.*, 332 F. Supp. 544, 568 (E.D.N.Y. 1971) (no duty to disclose in a prospectus methods of reorganization being "seriously investigated" by legal staff, which kept president apprised of progress, because plans had not "crystallized.").

Greenberg, 672 F.2d 1196, 1204-07 (3d Cir. 1982). In the majority's view, a standard of "constructive immateriality" applies to preliminary merger negotiations prior to an agreement in principle on price and structure. (20a, 21a.) The court held that this is a unique "policy exception . . . to the *Northway* and *Texas Gulf Sulphur* formulations of materiality" (22a), justified only for mergers, and inapplicable here, for two reasons: (i) "application of a different rule [to mergers] could scuttle corporate deals, costing shareholders desirable merger premiums" (21a), and (ii) mergers involve "negotiations with outside parties". (22a.)

Neither reason provides a principled basis for recognizing a different standard of materiality for preliminary consideration of a merger (even if the concept of merger already is supported by the Boards of both companies in principle) than for preliminary consideration of other possible corporate action (which, here, had not even been presented to the Board). The first rests on the assumption that shareholders benefit from mergers and, therefore, would prefer to be kept in the dark if disclosure would defeat the deal. *See, e.g., Flamm*, 814 F.2d at 1176-77. But this Court long ago rejected the notion that judicial appraisal of the merits of corporate action is a proper basis for resolving disclosure questions under the federal securities laws. *See Mills v. Elec. Auto-Lite Co.*, 396 U.S. at 381.

As for the second reason, the fact that merger negotiations involve third parties is relevant only because it demonstrates that the outcome of such discussions is unpredictable. Because the negotiations "may fail as well as succeed, or may succeed on terms which vary greatly from those under consideration at the suggested time of disclosure," such negotiations do not "definitely affect a company's financial prospects" and premature disclosure could be "more misleading than secrecy so far as investment decisions are concerned." *Reiss v. Pan Am. World Airways, Inc.*, 711 F.2d at 14. These considerations apply with equal force here, where the issue involved disclosure of one prospective alternative among many that were the subject of an unfinished study by an outside consultant and as

Supp. 492, 499 (S.D.N.Y. 1983), for the propositions that the "content of contingent speculations" and "the views held by individual directors"[14] need not be disclosed. 631 F. Supp. at 1264 and n.17.

We do not regard these decisions as controlling here. *Reiss* is representative of a current trend in the courts to hold preliminary merger negotiations immaterial as a matter of law for purposes of Section 10(b)/Rule 10b-5 liability. These cases, and our view of their inapplicability to the facts of this case, are discussed hereinafter. The citation of *Electronic Specialty* refers to an alleged statement by a corporation's president, in response to a financial reporter's question, that the corporation's "preference" was to sell its holdings in a potential target at a time when he had personally decided that it would be advisable to reactivate a tender offer for the target, but had not yet presented that conclusion to his board of directors, for whose authority (in Judge Friendly's words) he "manifested punctilious regard." 409 F.2d at 951. *Electronic Specialty* would be persuasive authority were plaintiff's case here based *solely* upon Mr. Salizzoni's view of the TWA-TWC relationship as of June, 1983, but that is clearly not the case. *Flum Partners* states that "the failure to disclose future business plans is also not actionable" at 557 F. Supp. 499. To the extent that this state-

14 The reference here is to Frank L. Salizzoni, who during 1983 served as senior vice president-finance of TWC, was a member of the TWC and TWA boards of directors and executive committees and the TWA finance committee, was chairman of the TWC finance committee, and acted as the primary TWC liason with Goldman Sachs concerning its study of TWC's structure and finances. He testified on deposition that in June, 1983, he had come to the conclusion that "TWA and [TWC] both could be better off if somehow we could separate the airline successfully in some manner."

ment is invoked as a general rule of law, rather than a disposition of the particular issues presented in that case, we deem it overbroad in view of *Texas Gulf Sulphur* and the cognate decisions cited hereinabove.

3. *The Preliminary Merger Discussion Cases.*

We turn next to *Reiss* and related cases that deal with the question of Section 10b/Rule 10b-5 liability with respect to preliminary merger discussions. The district court considered this a "related context," and deemed *Reiss* highly persuasive, if not controlling, here. 631 F. Supp. at 1264-65.

A recent line of cases has rejected arguments that preliminary merger negotiations should be disclosed to the investing public. For example, in *Staffin v. Greenberg*, 672 F.2d 1196 (3d Cir. 1982), the Third Circuit rejected claims that preliminary merger negotiations should have been disclosed to tender offerees and members of a broader class of open market sellers. It found preliminary merger discussions immaterial as a matter of law, finding merit in the opinions of other courts and commentators in the related area of takeover bids that disclosure of such discussions may do more harm than secrecy. *Id.* at 1206.[15] It held that a disclosure obligation

15 The Court concluded:

> Those persons who would buy stock on the basis of the occurrence of preliminary merger discussions preceding a merger which never occurs, are left "holding the bag" on a stock whose value was inflated purely by an inchoate hope. If the announcement is withheld until an agreement in principle on a merger is reached, the greatest good for the greatest number results. If the merger occurs, all of the company's shareholders usually benefit; if no merger agreement is reached, the stock performs as it would have in any event.

Staffin, 672 F.2d at 1207 (footnote omitted).

arises once an agreement in principle is reached. *Id.* at 1207.

In *Reiss v. Pan American World Airways, Inc.*, 711 F.2d 11 (2d Cir. 1983), this court resolved a Section 10(b)/ Rule 10b-5 action brought by holders of Pan Am convertible debentures who, pursuant to a call, sold their debentures rather than convert them into capital stock. Plaintiffs claimed that had they been aware that Pan Am was attempting to negotiate a merger with National Airlines, Inc., they would have converted their debentures. On appeal from a grant of summary judgment in Pan Am's favor, this Court affirmed, approving the rationale of *Staffin*. We noted that merger negotiations "are inherently fluid and the eventual outcome is shrouded in uncertainty. Disclosure may in fact be more misleading than secrecy so far as investment decisions are concerned. . . . [Merger negotiations involve] complex bargaining between two (and often more) parties which may fail as well as succeed, or may succeed on terms which vary greatly from those under consideration at the suggested time of disclosure." *Reiss*, 711 F.2d at 14.

Recently, in *Flamm v. Eberstadt*, 814 F. 2d 1169 (7th Cir. 1987), the Seventh Circuit followed *Staffin* and *Reiss* and held that a target company's search for a white knight was immaterial as a matter of law prior to agreement on the deal" price and structure.[16]

16 A related question which has produced a conflict among the circuits concerns whether a company, while negotiating a merger, may legally deny knowledge of new corporate developments. For example, in *Greenfield v. Heublein, Inc.*, 742 F.2d 751 (3d Cir. 1984), *cert. denied*, 105 S. Ct. 1189-90 (1985), the Third Circuit held that a company engaged in preliminary merger discussions could deny knowledge of new corporate developments which might account for an unusual upsurge in public trading in its stock in response to a query from the

We do not question the wisdom of the rule of "constructive immateriality," as one commentator terms it, as it has been applied in the preliminary merger context. *See generally* Note, *Rule 10b-5 and the Duty to Disclose Merger Negotiations in Corporate Statements*, 96 Yale L.J. 547 (1987) [hereinafter "Note, *Duty to Disclose*"]. Indeed, the application of a different rule there could scuttle corporate deals, costing shareholders desirable merger premiums, either because acquiring corporations generally insist on negotiating mergers in confidence and may terminate a deal that is disclosed prematurely, or because early disclosure may drive the target corporation's stock price so high as to make merger consumma-

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New York Stock Exchange without running afoul of the federal securities laws. Arguably, *Greenfield*'s result is limited to its facts and does not supply a rule for all cases in this area. The Court found that although the insiders of Heublein, Inc. "clearly knew" what might have accounted for the increase in trading, since there was no indication that privileged information respecting its preliminary merger discussions had leaked to the public or that insiders were trading in Heublein stock, the company's statement that it "was aware of no reason that would explain the activity in its stock . . ." was not false or misleading. *Id.* at 758-59; *but see id.* at 763 (Higginbotham, J., dissenting). In *Levinson v. Basic Inc.*, 786 F.2d 741 (6th Cir. 1986), *cert. granted*, 107 S. Ct. 1284 (1987), the Sixth Circuit reversed a grant of summary judgment in favor of a company which denied the existence of merger discussions in response to requests for "no corporate development" statements from the New York Stock Exchange, when in fact such discussions were taking place. *See generally* Note, *Rule 10b-5 and the Duty to Disclose Merger Negotiations in Corporate Statements*, 96 Yale L.J. 547 (1987). In the Supreme Court of the United States, the United States filed an *amicus curiae* brief in support of the petition for certiorari recently granted in *Levinson* in which it advocated application of the balancing test of *Texas Gulf Sulphur*. *See* Brief for the United States as Amicus Curiae in Support of Petition for Writ of Certiorari at 8-9, 15, *Basic Inc. v. Levinson*, No. 86-279, *cert. granted*, 107 S. Ct. 1284 (1987).

tion economically unfeasible. *See* Note, *Duty to Disclose* at 554-55; *see also Flamm*, 814 F. 2d at 1176-78.

4. *The Instant Case*

Similar concerns are not implicated here. Section 11 of the 1933 Act "was designed to assure compliance with the disclosure provisions of the Act by imposing a stringent standard of liability on the parties who play a direct role in a registered offering." *Herman & MacLean v. Huddleston*, 459 U.S. 375, 381-82 (1983) (footnotes omitted). The defendants at bar were in control of the timing of the TWA issue and of the response to the Odyssey proposal to a far greater degree than were the corporate defendants in the preliminary merger cases of the events unfolding there as a result of negotiations with outside parties. Here, we see no reason to carve out the policy exception recognized by cases such as *Staffin, Reiss* and *Flamm* to the *Northway* and *Texas Gulf Sulphur* formulations of materiality.

Texas Gulf Sulphur recognizes that contingencies inextricably bound up with a company's fortunes need not be certainties to qualify as material. Were defendants' arguments to carry the day, corporate actors would be granted the power to render facts—objectively material facts under the standard of *Northway*—immaterial as a matter of law by steering them clear of the board room. The Third Circuit seems to have recognized as much, even in the merger context, noting in *Staffin* that circumstances may arise where failure to disclose merger negotiations short of agreement in principle may nonetheless be actionable where the "functional equivalent" of agreement obtains. *Staffin*, 672 F.2d at 1207. As an example, the *Staffin* Court cited *Thomas v. Duralite Co.*, 524 F.2d 577

(3d Cir. 1975), a Section 10(b)/Rule 10b-5 case in which an insider was found liable on a record indicating that he deliberately postponed merger negotiations which had already yielded the "likelihood of acquisition" in order to purchase a large shareholder's stock at a favorable price. *Id.* at 585.

We conclude that the governing rule here is provided by *Northway* and *Texas Gulf Sulphur*, rather than the *Staffin/Reiss/Flamm* line of authority. We further conclude that, judged by the strict standard applicable to the granting of motions for summary judgment, especially concerning questions of materiality, defendants' motion should not have been granted in this case.

As we have stated earlier, the TWA prospectus discussed in some detail the relationship between TWA and TWC, so the question presented is whether that discussion omitted to state material facts necessary to make the statements therein not misleading; not whether, considered in the abstract, there was an obligation to disclose those facts at that time.[17] Plaintiff contends, in essence, that there should have been some reference to the ongoing Goldman Sachs study of TWC's structure and finances, and to the possibility of a termination of TWA's status as a TWC subsidiary.

It is not our role at this juncture, of course, to decide whether plaintiff is correct. Rather, we are to determine whether plaintiff raised a genuine issue of material fact concerning the matter. Fed. R. Civ. P. 56(c). In making this determination, we take into account the *Texas Gulf Sulphur* test calling for a balancing of the likelihood of an

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17 Substantially the same standard is stated in Section 11 of the 1933 Act and Rule 10b-5.

event's occurrence with its anticipated magnitude if it occurs "in light of the totality of the company activity," *Texas Gulf Sulphur*, 401 F.2d at 849, and decline to rule that no disclosure could be material, as a matter of law, until any proposal for the termination of TWA's status as a TWC subsidiary was presented to TWC's board of directors.

As to the magnitude of the event, we agree with the district court that:

> It is not disputed that the nature of the relationship between TWC and TWA, in which TWC guaranteed much of the credit upon which TWA did business and financed its substantial requirements for operating capital, was critical to the decisions faced by knowledgeable investors in evaluating TWA's value as an investment, particularly in view of the fact that TWA had suffered substantial losses in the period before July 29, 1983.

631 F. Supp. at 1263. Furthermore, when TWC announced on September 28, 1983 that it was "considering the possible separation of TWA," the price of TWA's common stock went into an immediate and sharp decline.

The likelihood of the event's occurrence cuts much less sharply in favor of plaintiff, but there was certainly, at a minimum, more than a wholly remote possibility of its occurrence. Especially given the fact that the TWC-TWA relationship was given considerable attention in the TWA prospectus, we cannot say, in ruling on a motion for summary judgment, that the evidence is "so one-sided that one party must prevail as a matter of law" and does not "present[ ] a sufficient disagreement to require sub-

mission to a jury." *Anderson v. Liberty Lobby, Inc.*, ____ U.S. ____, ____, 106 S. Ct. 2505, 2512 (1986).

For example, the discussion in the TWA prospectus of various arrangements and relationships between TWA and TWC stated that there might in the future be "other arrangements . . . [to] be determined on an arms-length basis," adding that "[t]here can be no assurance, however, that these terms will be favorable to TWA or that [TWC] will continue to provide TWA with the same level of support for TWA's financing and other needs as it has in the past." A jury might conclude that this language, while anticipating revisions of the multitude of relationships existing between TWA and TWC, did not give any fair indication that TWA's status as a TWC subsidiary might be terminated.

There was no mention in the TWA prospectus of the ongoing Goldman Sachs study. The district court noted that Goldman Sachs' activities in investigating alternative structures for TWC "had been extensively publicized by TWC in connection with the proxy solicitation by Odyssey Partners." 631 F. Supp. at 1265. All of TWC's activity in that regard pre-dated the annual meeting of TWC which occurred on April 27, 1983, however, and on June 23, 1983, TWC issued a press release in which its chairman stated that "[TWC] now has set targets that by 1987 its presently unprofitable airline subsidiary, TWC, should become a source of $100 million in pre-tax profits . . ." There are serious limitations on a corporation's ability to charge its stockholders with knowledge of information omitted from a document such as a proxy statement or prospectus on the basis that the information is public knowledge and otherwise available to them. *See Spielman v. General Host Corp.*, 538 F.2d 39, 40-41 (2d Cir. 1976)

(*per curiam*); *Fisher v. Plessy Co. Ltd.*, 559 F. Supp. 442, 445-48 (S.D.N.Y. 1983). At a minimum, in any event, an issue is presented whether purchasers of TWA's cumulative convertible preferred stock could properly be charged with knowledge on July 29, 1983 and thereafter that Goldman Sachs was then engaged in a study on behalf of TWC one of the live options of which was a termination of TWA's status as a TWC subsidiary. That it was then live is evidenced by Ms. Casati's notes taken at the July 7 meeting of Goldman Sachs representatives with TWC officials, despite her inability upon deposition to recollect what was said or meant.

Plaintiff also points out that, although defendants contend that it would have been inappropriate to discuss in the July prospectus any of the options under consideration by Goldman Sachs prior to their consideration by the TWC board of directors, one of those options, additional sales of TWA stock, was in fact so discussed. The prospectus stated that consents had been obtained from TWC's lenders to allow creation of up to a forty percent public holding of TWA's common stock, and that TWA and TWC might make future sales which would increase the public holding beyond forty percent, assuming any required consents of lenders and stockholders were obtained.[18] Additional sales of TWA stock was one of the options under consideration by Goldman Sachs.

There is other evidence of record that bears upon the ultimate issue of a material omission. For example, although the Odyssey proposal called for a "disaggregation" of TWC's five subsidiaries, there is evidence

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18 We recognize the pertinence in the July prospectus of a possible occurrence which could dilute the common stock into which the preferred stock offered by that prospectus was convertible.

indicating that Odyssey privately informed Mr. Salizzoni that it would be satisfied if only TWA were separated from the holding company. The record also indicates that some significant shareholders supported the Odyssey proposal, but felt it best to let management work things out without the pressure of a shareholder resolution. Alliance Capital Management Corporation, for example voted over 750,000 shares owned by its pension and endowment fund clients against the Odyssey proposal, but contemporaneously indicated in a letter dated April 27, 1983 to L. Edwin Smart, TWC's chairman, that it saw "much merit to the Odyssey plan."[19] Nor would a jury be required to accept at face value the testimony of defendants' witnesses that the Goldman Sachs study was not presented to TWC's board of directors in July, 1983, as originally planned and prior to the TWA public offering, solely because the study was not then ready to be presented. *See Adickes v. S.H. Kress & Co.*, 398 U.S. 144, 157-58 (1970).

The foregoing does not constitute an exhaustive recital of the evidentiary points plaintiff might make at trial, and of course, given the issue presented to us, does not touch upon the ripostes available to defendants. Enough

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19 The letter continued, in pertinent part, as follows:

> Further, we thought the Odyssey proposal put management under too much pressure for fast action on divesting or selling assets. Finally, we saw no virtue at all to the Corporation selling assets; we would only favor partial or total spinoff of subsidiaries to stockholders.
>
> * * *
>
> The minority divestiture of Trans World Airlines, Inc. is a step in the right direction, and we are shareholders. We hope this is a first move towards spinning off to shareholders more of TWA and other subsidiaries which have "stand alone" capability.

has been said, however, to make it clear that, under the standards provided by *Northway* and *Texas Gulf Sulphur*, plaintiff tendered genuine issues of material fact as to whether there were material omissions in TWA's July 29, 1983 prospectus. Accordingly, summary judgment should not have been rendered in favor of defendants.

CONCLUSION

In the interests of caution, we wish to stress that our discussion of certain factual issues and evidence herein, for the limited purpose of demonstrating the existence of genuine issues of marerial fact precluding summary judgment, intimates no view whatever concerning the merits and ultimate outcome of this litigation. The judgment of the district court is reversed and the case remanded for further proceedings not inconsistent with this opinion.

MINER, *Circuit Judge*, dissenting:

Since I cannot agree that there is any triable issue of fact as to whether TWA's July 29, 1983 prospectus contained any untrue material fact or omitted to state any material fact, I respectfully dissent.

Although the spin-off of TWA always was a *possibility*, it was only one of a number of options available to TWC management for dealing with its problems in regard to TWA at the time the prospectus was issued. It seems clear that no decision of any kind was made until Goldman Sachs placed *seven* alternative choices before the TWC Board of Directors on September 6, 1983. The Goldman

Sachs report was referred to the Board's Finance Committee for consideration, and, on September 27, 1983, the Committee recommended one of the seven options—development of a program to separate TWA from TWC. The directors did not adopt a formal plan of separation until October 23, 1983, almost three months after the issuance of the prospectus upon which plaintiff predicates his claim.

The prospectus gave specific notice to prospective shareholders of TWA that TWC might not provide the same financial support to TWA as it had provided in the past. The shaky financial condition of TWA was apparent from the financial information furnished to those interested in purchasing shares at the public offering, and the prospectus gave further notice that TWC might "sell or otherwise dispose of" its shares of TWA. The information provided was full and complete, potential investors were cautioned adequately as to the problems facing the company, and there was no false representation of any kind. A jury should not be afforded the opportunity to speculate otherwise.

I cannot agree that the statement in the prospectus giving notice of the possibility of withdrawal of financial support by TWC "did not give any fair indication that TWA's status as a TWC subsidiary might be terminated." The withdrawal of financial support could be seen to lead to a total collapse of TWA, let alone termination of its status as a subsidiary. Moreover, another provision in the prospectus warning that TWC might sell its shares clearly indicated the possibility of spin-off. The risky nature of an investment in TWA should have been apparent to all those who took the time to examine the prospectus. Nor do I agree that there is an issue whether stock purchasers

can be charged with knowledge that Goldman Sachs was undertaking a study involving the "live" option of separation. It seems to me that there was no need to notify prospective purchasers of the study at all, because the study was in progress and had produced no options, "live" or otherwise, at the time of the public offering.

The mere fact that the Odyssey proxy battle centered on a proposal for "disaggregation" of TWC's subsidiaries does not create a triable issue as to whether divestiture of TWA should have been included in the prospectus. The Odyssey proposal was defeated, partially on the strength of the pending Goldman Sachs review of all available "structural and financial" alternatives. Although Mr. Salizzoni, a senior vice-president and director of TWC, had concluded in June 1983 that separation was desirable, there is no indication that his opinion was imparted to any other board member or that any other board member held the same view. In point of fact, Odyssey's defeat in the proxy contest represented a corporate rejection of the separation proposal. With regard to the Casati notes, I fail to see how the idle scribblings of a minor functionary of Goldman Sachs during a meeting with TWC representatives could possibly be indicative of material facts required to be revealed in a prospectus.

Resolution of the question of materiality requires an assessment of the "probability that the event will occur." *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833, 849 (2d Cir. 1968) (in banc), *cert. denied*, 394 U.S. 976 (1969). There simply is no way in which the evidence can be viewed so as to permit a finding that spin-off was any more probable at the time the prospectus was issued than any of the six other options eventually considered. That being so, and there being no *genuine* factual issue of any

kind remaining in the case, summary judgment must be granted to the defendants. *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, ____, 106 S. Ct. 2505, 2511, 91 L.Ed.2d 202, 213 (1986). Where summary judgment is appropriate, it should be granted without hesitation. *See Knight v. U.S. Fire Insurance Co.*, 804 F.2d 9, 11-12 (2d Cir. 1986), *cert. denied*, 107 S. Ct. 1570, 94 L.Ed.2d 762 (1987). *See generally* New York State Bar Assoc. Comm. on Fed. Courts, Summary Judgment in the Second Circuit (Mar. 23, 1987) (unpublished manuscript). I respectfully suggest that it is appropriate here.

Order Amending the Opinion and Denying the Petition for Rehearing

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

At a stated term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Courthouse, in the City of New York, on the 28th day of December, one thousand nine hundred and eighty-seven.

86-7330

JOEL KRONFELD,

Plaintiff-Appellant,

—v.—

TRANS WORLD AIRLINES, INC.; TRANSWORLD CORPORATION,

Defendants-Appellees.

A petition for rehearing, having been filed by defendants-appellees in the above entitled case.

Upon consideration by the panel that heard the appeal, it is ordered as follows:

1. The opinion of the Court filed November 2, 1987 is amended as follows:

a. The paragraph that begins with the words "*Sonesta International*" at line four of slip page 5830 and concludes with the words "(citation omitted)" at line twenty of slip page 5831 is deleted.

b. The sentence that begins on line twenty-three of slip page 5838 is amended to read as follows:

> The likelihood of the event's occurrence cuts much less sharply in favor of plaintiff, but there was certainly, at a minimum, a substantial possibility of its occurrence.

c. The sentence that begins on line eleven of slip page 5839 is amended to read as follows:

> A jury might conclude that this language, while anticipating revisions of the multitude of relationships existing between TWA and TWC, did not give any fair indication of the equally substantial possibility that TWA's status as a TWC subsidiary might be terminated.

d. The following sentence is added after the words "be terminated" at line 15 of slip page 5839, concluding the paragraph that presently ends with the words "be terminated":

> Indeed, the suggestions of diminished future support of TWA by TWC, and of possible future sales of some TWA stock, could both be read to imply that some continuing relationship between TWC and TWA, although one less favorable to the latter, was contemplated.

2. The petition for rehearing is DENIED.

/s/ JAMES L. OAKES (illegible)
James L. Oakes,

/s/ J. DANIEL MAHONEY
J. Daniel Mahoney,

Circuit Judges.

N. B. THIS SUMMARY ORDER WILL NOT BE PUBLISHED IN THE FEDERAL REPORTER AND SHOULD NOT BE CITED OR OTHERWISE RELIED UPON IN UNRELATED CASES BEFORE THIS OR ANY OTHER COURT.

Order Denying the Suggestion for Rehearing In Banc

UNITED STATES COURT OF APPEALS

SECOND CIRCUIT

At a stated term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Courthouse, in the City of New York, on the 30th day of December, one thousand nine hundred and eighty-seven.

Docket No. 86-7330

JOEL KRONFELD,

Plaintiff-Appellant,

—v.—

TRANSWORLD AIRLINES, INC., and
TRANSWORLD CORPORATION,

Defendants-Appellees.

A petition for rehearing containing a suggestion that the action be reheard in banc having been filed by the defendants-appellees in the above entitled case and the panel that heard the appeal having denied the petition for rehearing by order dated December 28, 1987.

It is noted that the suggestion for rehearing in banc has been transmitted to the judges of the court in regular active service and to any other judge on the panel that heard the appeal and that no such judge has requested that a vote be taken thereon.

/s/ ELAINE B. GOLDSMITH
Elaine B. Goldsmith
Clerk

Opinion of the Southern District of New York

UNITED STATES DISTRICT COURT

S.D. NEW YORK

March 31, 1986

No. 83 Civ. 8641 (EW)

JOEL KRONFELD,

Plaintiff,

—v.—

TRANS WORLD AIRLINES, INC.
and TRANS WORLD CORPORATION,

Defendants.

Pomerantz, Levy, Haudek, Block & Grossman, Harvey Greenfield, New York City, for plaintiff; Stanley M. Grossman, Bruce G. Stumpf, Shaheen Rushd, of counsel.

Hughes, Hubbard & Reed, New York City, for defendants; Robert J. Sisk, Norman C. Kleinberg, Rebecca Northey, Janice B. Stanton, Bradley J. Andreozzi, of counsel.

EDWARD WEINFELD, *District Judge*:

Plaintiff, suing on behalf of a class of purchasers of securities of Trans World Airlines ("TWA" or "the Airline"), alleges

violations of § 10(b) of the Securities Exchange Act of 1934[1] and § 11 of the Securities Act of 1933.[2] Plaintiff alleges that the July 29, 1983 prospectus by which TWA offered a new issue of convertible preferred stock failed to disclose that TWA's parent company, defendant Trans World Corporation ("TWC" or "Trans World"), was considering a "spinoff" transaction in which TWA would be separated from TWC. Defendants move for summary judgment. The motion must be considered against the background of events which preceded and led to the spinoff of TWA from TWC.

In late 1982 and early 1983 Odyssey Partners ("Odyssey"), a private investment partnership with holdings in TWC securities, approached TWC's management with a proposal to "disaggregate" TWC's corporate holdings, which included, along with TWA, Hilton International Hotels, Century 21 Real Estate, Spartan Corporation, and Canteen Corporation. After initial private discussions between the Odyssey group and TWC management, Odyssey solicited shareholder proxies for a proposal requesting TWC's Board to study and report to the shareholders on the possibility of establishing TWC's subsidiaries as independent corporations.[3] In support of its proxy

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1 15 U.S.C. § 78j(b).

2 15 U.S.C. § 77k. Plaintiff's complaint also stated a claim under § 12(2) of the 1933 Act, 15 U.S.C. § 77*l*(2), which has been voluntarily discontinued.

3 The proxy resolution stated, in its effective sentence, that:

> the stockholders of Trans World Corporation, assembled at the 1983 Annual Meeting, request and recommend that the Board of Directors develop and implement a program to separate [the affiliates] by spinning off the primary subsidiaries of Trans World Corporation to the stockholders to create independently traded public corporations or by selling some of the primary subsidiaries, and that a committee of non-management members of the Board of Directors report to the stockholders by August 31, 1983 on the best means to consummate this separation at the earliest practicable date.

Trans World Corporation Proxy Statement, March 24, 1983, Affidavit of Frank Salizzoni, Exhibit A, at 18-19.

solicitation, Odyssey argued that the securities of the disaggregated subsidiaries would trade at a net premium over the trading value of TWC stock, in large part because, in Odyssey's view, the poor financial performance of TWA was adversely affecting the market in TWC securities.

In late 1982, TWC engaged the services of the investment banking firm of Goldman, Sachs & Co. to assist it in opposing the Odyssey proxy proposal. Goldman, Sachs prepared an analysis of the Odyssey proposal which criticized Odyssey's financial projections for TWC and its subsidiaries, and which formed the basis for TWC's communications to its shareholders in opposition to the Odyssey solicitation. In addition, Goldman, Sachs was charged by TWC's management with the conduct of an independent review of the financial and structural alternatives available to TWC, including the spin-off of one or more of the subsidiaries. The fact that Goldman, Sachs was conducting such a study was announced by TWC in its proxy materials, and was offered as an additional reason why shareholders should vote against the Odyssey proposal:

> The Company several months ago retained a leading investment banking firm—Goldman, Sachs & Co.—which is providing independent advice with respect to the relative merits of the diversification of Trans World, including the structural and financial alternatives available to the Company. Goldman, Sachs & Co. will report their findings to the Board well ahead of the August 31 date specified in the Odyssey Proposal. In addition, their advice and assistance will continue to be provided on an ongoing basis, in the light of changing conditions, both current and prospective.[4]

After an undisputedly heated proxy contest, involving extensive publicity by Odyssey and TWC's management, the Odys-

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4 Trans World Corporation Proxy Statement, March 24, 1983, Affidavit of Frank Salizzoni, Exhibit A, at 19.

sey shareholder proposition was defeated at the annual meeting held on April 27, 1983.

Despite the defeat of the Odyssey proposal, Goldman, Sachs continued its review of alternatives with respect to TWA and the four other TWC subsidiaries. Although it was originally intended that the Goldman, Sachs study would be ready for consideration by TWC's Board at its July meeting, Goldman, Sachs had not completed it by that time, and the presentation was therefore scheduled for a special meeting of the Board on September 6, 1983.

During this period, TWA continued its loss record with little prospect of improvement. The TWA and TWC Boards were considering the possibility of a public offering of TWA securities to meet TWA's capital requirements. Despite the airline's substantial operating losses in the preceding quarters, the TWA and TWC Boards believed that the market climate was favorable for an issuance of stock. TWA had, beginning in January 1983, offered some of its own securities on the public market, as a result of which TWC's share of TWA's outstanding stock had been reduced from 100% to approximately 80%, and TWA and TWC had sought and obtained approval from their major lenders for sale to the public of up to 40% of TWA.

On July 29, 1983, TWA filed a registration statement with the SEC, and issued a prospectus for the sale of 4,000,000 shares of convertible preferred stock at an initial price of $25 per share. Among the subject headings in the prospectus was one labeled "RELATIONSHIP BETWEEN TWA AND TRANS WORLD." Preceding the description of the existing financial and other relationships between the parent and subsidiary was the following statement:

> There may in the future be other arrangements between TWA and Trans World (or other of its subsidiaries). It is intended that the terms of these arrangements will be determined on an arms-length basis. There can be no assurance, however, that these terms will be favorable to TWA or that Trans World will continue to provide TWA

with the same level of support for TWA's financing and other needs as it has in the past.[5]

Subsequent to the publication of the prospectus, on September 6, 1983, the results of the Goldman, Sachs study were presented to the TWC Board of Directors. The presentation outlined seven options for the consideration of the Board: Liquidation of TWC through sale of all the subsidiaries; sale of TWC as a single entity; sale of TWA or other subsidiaries individually; continuation of offers to TWA stock to the public; separation of TWC into two entities consisting of TWA and all the other subsidiaries taken together; and retention of the established corporate structure.[6] The Goldman, Sachs presentation was limited to the review of these options "from a financial and market perspective only,"[7] and did not recommend adoption of any particular option.

After the presentation by Goldman, Sachs on September 6, TWC's Board referred the matter to its Finance Committee for further consideration. The Finance Committee met on two occasions, with other members of the Board present and participating. On September 27, the Finance Committee unanimously recommended "that the Board authorize management to develop a detailed program for a possible separation of TWA from TWC, and to proceed with related preparations." This "spinoff" proposal was considered by the full Board on September 28, at which time it was publicly announced that TWC was considering a plan of separation. Such a plan was formally adopted by the Board on October 26, approved by the shareholders on December 28, and became effective on February 1, 1984. At the time of first announcement that the Board was considering separation, TWA's stock dropped sharply in the market from the $25 per share offering price

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5 Prospectus, July 29, 1983. Affidavit of Frank Salizzoni, Exhibit H, at 29.

6 Presentation to the Board of Directors, September 6, 1983. Affidavit of Stanley Grossman, Exhibit Y, at 6.

7 Presentation Script, Affidavit of Stanley Grossman, Exhibit G, at 5.

which plaintiff paid when he purchased shares of the newly-issued preferred stock offering on July 29.

DISCUSSION

Although the spinoff took place some five months after his purchase, plaintiff charges the defendants with fraudulent conduct in the omission of material facts from the prospectus issued on July 29. Plaintiff contends that TWA and TWC misled potential purchasers by failing to disclose in the prospectus that TWC was considering a spinoff of TWA, and that "Goldman Sachs was preparing to recommend to [TWC] the spinoff of TWA."[8] Plaintiff contends that this information was material because TWA was dependent upon the financial guarantees and other assistance provided by TWC, and that these disclosures were required in order to make other statements in the prospectus not misleading. Accordingly, plaintiff argues, he and the other members of the class, who purchased shares of the newly-issued preferred between July 29 and the September 28 announcement that TWC was considering a spinoff of TWA, were fraudulently deprived of material information upon the absence of which they relied in making their investment decisions.

Defendants, in support of their motion for summary judgment, contend that the undisputed facts establish that at the time plaintiff purchased his shares, which he did on the first day of availability, July 29, 1983, TWC and TWA were under no duty to disclose any facts not contained in the prospectus. Defendants maintain that the undisputed record shows that there were no "plans" to separate TWA from TWC on that date, or at any time before the public announcement that the Board was considering such a proposal on September 28.

To demonstrate that TWC planned to separate TWA from its other holdings at the time that the July 29 offering took place, plaintiff relies heavily upon the statements and conduct of Frank Salizzoni, who was at all material times the Chief

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8 Complaint, ¶¶ 7, 26, 27.

Financial Officer of TWC, a member of the Boards of Directors of TWC and TWA, and the officer of TWC most directly involved with the supervision of the Goldman, Sachs study. Salizzoni stated at his deposition that in June 1983 he had come to the "personal opinion" that TWA and TWC "both could be better off it somehow we could separate the airline successfully in some manner."[9] On the basis of this and similar statements, plaintiff argues that despite a "public facade" of continuing study, defendants "behind the scenes . . . pursued the separation of TWA."[10] As evidence of this "behind the scenes" determination, plaintiff offers handwritten notes taken by a junior employee of Goldman, Sachs, Mary Anne Cassati, of a meeting between members of the Goldman, Sachs team and Salizzoni on July 7, 1983. Salizzoni states that this meeting was a "status meeting," during the course of which it was determined that the Goldman, Sachs study had not progressed sufficiently to be presented to TWC's Board at its July meeting, as originally planned. Cassati testified at her deposition that she understood the meeting to be a "kick-off" meeting, at which Goldman, Sachs would present its view of its task, and make requests for further information.[11] Casatti's informal notes state, under a heading "2 AIRLINE SALE/SPINOFF": "*primary*—goal—build liquidity in airline & cut cord w/ TWC so they can walk away." Elsewhere under the same heading, in the margin, is written in large block capitals "TILL DEATH DO US PART."[12] There is no attribution in the document of the source of either of these potentially contradictory statements. Plaintiff argues that this document confirms that before the issuance of the July 29 prospectus, at least one officer and director of TWC had concluded that TWC should "build liquidity" in TWA (presumably through the forthcoming stock offering) so as to subsequently "cut [the] cord . . . and walk away." Defendants, while denying the inferences drawn by

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9 Salizzoni Dep. Tr., at 98.

10 Plaintiff's Memorandum in Opposition, at 16.

11 Affidavit of Frank Salizzoni, ¶ 6; Cassati Dep.Tr. at 20.

12 Affidavit of Stanley Grossman, Exhibit R, at 1.

plaintiff, contend that even if plaintiff's factual premises were true, TWC was not under a duty to reveal the speculations or plans of a single officer and director, or the direction of Goldman, Sachs's unfinished study of possible course of action, and that summary judgment is appropriate.

In passing upon defendants' motion, this Court is mindful of the principle often expressed by our Court of Appeals that summary judgment is a "drastic remedy" in cases such as this;[13] it is a rule too well-settled to require any further elucidation that the Court's only function upon such a motion is to decide whether there are issues of fact to be tried, and not to try them.[14] Rule 56 must nonetheless be enforced where its enforcement is justified, otherwise the Rule becomes a "dead letter."[15]

However variously stated, the essence of plaintiff's claim is that on July 29, 1983, when TWA issued the prospectus and plaintiff purchased his shares, TWC had already determined upon the separation of TWA from TWC, that TWC had a duty to disclose its decision to its investors, and that the existence of this decision was a material matter upon which a reasonable investor would have relied in making his investment choices. Materiality vel non is a mixed question of law and fact, which should ordinarily be determined by the fact-finder upon the

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13 *Gary Plastic Packaging Corp. v. Merrill, Lynch*, 756 F.2d 230, 236 (2d Cir. 1985); *see Eastway Construction Corp. v. City of New York*, 762 F.2d 243, 249 (2d Cir. 1985); *Seguros Banvenez, S.A. v. S/S Oliver Drescher*, 761 F.2d 855, 859 (2d Cir. 1985).

14 *Meiri v. Dacon*, 759 F.2d 989, 992 (2d Cir. 1985); *Heyman v. Comm. & Indus. Ins. Co.*, 524 F.2d 1317, 1319-20 (2d Cir. 1975).

15 *See Colan v. Continental Telecom, Inc.*, 616 F.Supp. 1521, 1525 (S.D.N.Y. 1985), *aff'd mem.*, 788 F.2d 2 (2d Cir. 1986); *Cf. Meinrath v. Singer*, 482 F.Supp. 457, 460 (S.D.N.Y. 1979), *aff'd*, 697 F.2d 293 (2d Cir. 1982); *Applegate v. Top Assoc. Inc.*, 300 F.Supp. 51, 53 (S.D.N.Y. 1969), *aff'd*, 425 F.2d 92 (2d Cir. 1970); *Schwartz v. BMI*, 180 F.Supp. 322, 325 (S.D.N.Y. 1959); *Morgan v. Sylvester*, 125 F.Supp. 380, 389 (S.D.N.Y. 1954), *aff'd*, 220 F.2d 758 (2d Cir.), *cert. denied*, 350 U.S. 867, 76 S.Ct. 112, 100 L.Ed. 768 (1955).

trial,[16] but the issue of materiality arises only with respect to facts as to which there was a duty to disclose. Upon the undisputed factual record in this case, taking all facts in the light most favorable to plaintiff and resolving all disputed issues of fact in the plaintiff's favor, the Court is satisfied that, as a matter of law, defendants had no duty to disclose additional information, beyond that contained in the July 29 prospectus, regarding the relationship between TWC and TWA, or the activities of Goldman, Sachs.

It is not disputed that the nature of the relationship between TWC and TWA, in which TWC guaranteed much of the credit upon which TWA did business and financed its substantial requirements for operating capital, was critical to the decisions faced by knowledgeable investors in evaluating TWA's value as an investment, particularly in view of the fact that TWA had suffered substantial losses in the period before July 29, 1983. The prospectus, as noted earlier, addressed itself to this relationship, and contained numerous statements which informed investors that the existing relationship between TWC and TWA was under review and might be subject to significant change. Even if, as plaintiff contends, Salizzoni, an officer of TWC and TWA and an influential member of the Boards of both companies, had come to an individual judgment as to the nature and advisability of such future change, and even if he had conveyed his views to the Goldman, Sachs team which was preparing its report to the Board, his opinions, speculations, and plans were not matters of fact which defendants were under any duty to disclose. The decisions on fundamental matters of corporate ownership, organization, and governance were not decisions committed to the judgment of a single officer or officers of TWA and TWC; they were matters to be determined in the first instance by the Boards of Directors of the two companies, and ultimately by the stockholders who were the owners of the enterprises.

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16 *See TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 450, 96 S.Ct. 2126, 2133, 48 L.Ed.2d 757 (1976); *Goldman v. Belden*, 754 F.2d 1059, 1967 (2d Cir. 1985).

The opinions of individual officers of the corporation, however strongly held and however disseminated to the corporation's hired consultants, involved forecasts of future contingencies whose "eventual outcome [was] shrouded in uncertainty"; there is no obligation to disclose the content of such contingent speculations, or of the views held by individual directors.[17] There is no dispute that at the time the prospectus was issued, TWC's Board of Directors had not considered a proposal to change the relationship between TWC and TWA; indeed, it is undisputed that no such proposal had been put forward since the defeat by the shareholders of the Odyssey Partners proposal in April. The study which was under way was directed toward the identification and analysis of *options* for consideration by TWC's Board; it is undisputed that Goldman, Sachs put forward no recommendation upon presentation of its report.

Indeed, the course of events after presentation of the Goldman, Sachs report, while not determinative of the question which matters defendants had a duty to disclose on July 29, shows the highly uncertain nature of the proposal to separate TWA from TWC. It is undisputed that the reaction of TWC's Board to the initial presentation of the idea of separation included, in the words of TWC's Chairman and Chief Executive Officer, substantial expressions of "surprise, concern, and opposition."[18] The proposal was initially referred to the Board's Finance Committee, and only after further study and discussion, in which other members of the Board also participated, was the proposal again considered and approved.

The record thus demonstrates that, even granting plaintiff's inferences from the facts established concerning the views of TWC's officers, particularly Salizzoni, in the period before July 29, 1983, any "plans" for the separation of TWA from

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17 *See Reiss v. Pan American World Airways, Inc.*, 711 F.2d 11, 14 (2d Cir. 1983); *Electronic Specialty Co. v. International Controls Corp.*, 409 F.2d 937, 951 (2d Cir. 1969); *Flum Partners v. Child World, Inc.*, 557 F.Supp. 492, 499 (S.D.N.Y. 1983).

18 Affidavit of L. Edwin Smart, TWC Chairman & Chief Executive Officer, ¶ 10.

TWC were the tentative views of individuals regarding the possible outcome of future discussions and deliberations. With the Goldman, Sachs study not completed, while individual directors might have come to individual judgments, these did not reflect final corporate determinations. Indeed, such individual views might well have yielded to contrary opinions held by other directors following discussion at Board meetings. In short, for example, the nature of Salizzoni's views was not a material fact which TWC was required to disclose. To hold otherwise would be to require the disclosure of the views of each of the other directors, all prior to definitive action by the Board. As our Court of Appeals has said, in the related context of incipient merger negotiations, "[w]e are not confronted here with a failure to disclose hard facts which definitely affect a company's financial prospects"; under such circumstances, "[d]isclosure may in fact be more misleading than secrecy so far as investment decisions are concerned."[19] The activities of Goldman, Sachs in investigating alternative structures for TWC had been extensively publicized by TWC in connection with the proxy solicitation by Odyssey Partners; the continuation of that investigation was a matter of prudent business judgment in light of the strong shareholder support which had been garnered by Odyssey in the course of its unsuccessful campaign. But it was TWC and TWA's Boards which were charged with receiving the results of that investigation and weighing the seven alternatives set forth in the study; TWC was under no obligation to anticipate the outcome of that deliberative process, and to disclose mere contingencies long in advance of the first consideration of the question by those responsible for decision.

Accordingly, defendants' motion for summary judgment is granted. Judgment may be entered dismissing the complaint.

So ordered.

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19 *Reiss v. Pan American World Airways, Inc.*, 711 F.2d 11, 14 (2d Cir. 1983).

Statutory and Regulatory Provisions Involved

United States Code

Title 15

Section 11 of the Securities Act of 1933

§ 77k. *Civil liabilities on account of false registration statement*

(a) Persons possessing cause of action; persons liable

In case any part of the registration statement, when such part became effective, contained an untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading, any person acquiring such security (unless it is proved that at the time of such acquisition he knew of such untruth or omission) may, either at law or in equity, in any court of competent jurisdiction, sue—

(1) every person who signed the registration statement;

(2) every person who was a director of (or person performing similar functions) or partner in the issuer at the time of the filing of the part of the registration statement with respect to which his liability is asserted;

(3) every person who, with his consent, is named in the registration statement as being or about to become a director, person performing similar functions, or partner;

(4) every accountant, engineer, or appraiser, or any person whose profession gives authority to a statement made by him, who has with his consent been named as having prepared or certified any part of the registration statement, or as having prepared or certified any report or valuation which is used in connection with the registration statement, with respect to the statement in such registration statement, report, or valuation, which purports to have been prepared or certified by him;

(5) every underwriter with respect to such security.

If such person acquired the security after the issuer has made generally available to its security holders an earning statement covering a period of at least twelve months beginning after the effective date of the registration statement, then the right of recovery under this subsection shall be conditioned on proof that such person acquired the security relying upon such untrue statement in the registration statement or relying upon the registration statement and not knowing of such omission, but such reliance may be established without proof of the reading of the registration statement by such person.

(b) Persons exempt from liability upon proof of issues

Notwithstanding the provisions of subsection (a) of this section no person, other than the issuer, shall be liable as provided therein who shall sustain the burden of proof—

(1) that before the effective date of the part of the registration statement with respect to which his liability is asserted (A) he had resigned from or had taken such steps as are permitted by law to resign from, or ceased or refused to act in, every office, capacity, or relationship in which he was described in the registration statement as acting or agreeing to act, and (B) he had advised the Commission and the issuer in writing that he had taken such action and that he would not be responsible for such part of the registration statement; or

(2) that if such part of the registration statement became effective without his knowledge, upon becoming aware of such fact he forthwith acted and advised the Commission, in accordance with paragraph (1) of this subsection, and, in addition, gave reasonable public notice that such part of the registration statement had become effective without his knowledge; or

(3) that (A) as regards any part of the registration statement not purporting to be made on the authority of an expert, and not purporting to be a copy of or extract

from a report or valuation of an expert, and not purporting to be made on the authority of a public official document or statement, he had, after reasonable investigation, reasonable ground to believe and did believe, at the time such part of the registration statement became effective, that the statements therein were true and that there was no omission to state a material fact required to be stated therein or necessary to make the statements therein not misleading; and (B) as regards any part of the registration statement purporting to be made upon his authority a an expert or purporting to be a copy of or extract from a report or valuation of himself as an expert, (i) he had, after reasonable investigation, reasonable ground to believe and did believe, at the time such part of the registration statement became effective, that the statements therein were true and that there was no omission to state a material fact required to be stated therein or necessary to make the statements therein not misleading, or (ii) such part of the registration statement did not fairly represent his statement as an expert or was not a fair copy of or extract from his report or valuation as an expert; and (C) as regards any part of the registration statement purporting to be made on the authority of an expert (other than himself) or purporting to be a copy of or extract from a report or valuation of an expert (other than himself), he had no reasonable ground to believe and did not believe, at the time such part of the registration statement became effective, that the statements therein were untrue or that there was an omission to state a material fact required to be stated therein or necessary to make the statements therein not misleading, or that such part of the registration statement did not fairly represent the statement of the expert or was not a fair copy of or extract from the report or valuation of the expert; and (D) as regards any part of the registration statement purporting to be a statement made by an official person or purporting to be a copy of or extract from a public official document, he had no reasonable ground to believe

and did not believe, at the time such part of the registration statement became effective, that the statements therein were untrue, or that there was an omission to state a material fact required to be stated therein or necessary to make the statements therein not misleading, or that such part of the registration statement made by the official person or was not a fair copy of or extract from the public official document.

(c) Standard of reasonableness

In determining, for the purpose of paragraph (3) of subsection (b) of this section, what constitutes reasonable investigation and reasonable ground for belief, the standard of reasonableness shall be that required of a prudent man in the management of his own property.

(d) Effective date of registration statement with regard to underwriters

If any person becomes an underwriter with respect to the security after the part of the registration statement with respect to which his liability is asserted has become effective, then for the purposes of paragraph (3) of subsection (b) of this section such part of the registration statement shall be considered as having become effective with respect to such person as of the time when he became an underwriter.

(e) Measure of damages; undertaking for payment of costs

The suit authorized under subsection (a) of this section may be to recover such damages as shall represent the difference between the amount paid for the security (not exceeding the price at which the security was offered to the public) and (1) the value thereof as of the time such suit was brought, or (2) the price at which such security shall have been disposed of in the market before suit, or (3) the price at which such security shall have been disposed of after suit but before judgment if such damages shall be less than the damages representing the difference between the amount paid for the security (not

exceeding the price at which the security was offered to the public) and the value thereof as of the time such suit was brought: *Provided*, That if the defendant proves that any portion or all of such damages represents other than the depreciation in value of such security resulting from such part of the registration statement, with respect to which his liability is asserted, not being true or omitting to state a material fact required to be stated therein or necessary to make the statements therein not misleading, such portion of or all such damages shall not be recoverable. In no event shall any underwriter (unless such underwriter shall have knowingly received from the issuer for acting as an underwriter some benefit, directly or indirectly, in which all other underwriters similarly situated did not share in proportion to their respective interests in the underwriting) be liable in any suit or as a consequence of suits authorized under subsection (a) of this section for damages in excess of the total price at which the securities underwritten by him and distributed to the public were offered to the public. In any suit under this or any other section of this subchapter the court may, in its discretion, require an undertaking for the payment of the costs of such suit, including reasonable attorney's fees, and if judgment shall be rendered against a party litigant, upon the motion of the other party litigant, such costs may be assessed in favor of such party litigant (whether or not such undertaking has been required) if the court believes the suit or the defense to have been without merit, in an amount sufficient to reimburse him for the reasonable expenses incurred by him, in connection with such suit, such costs to be taxed in the manner usually provided for taxing of costs in the court in which the suit was heard.

(f) Joint and several liability

All or any one or more of the persons specified in subsection (a) of this section shall be jointly and severally liable, and every person who becomes liable to make any payment under this section may recover contribution as in cases of contract from

any person who, if sued separately, would have been liable to make the same payment, unless the person who has become liable was, and the other was not, guilty of fraudulent misrepresentation.

(g) Offering price to public as maximum amount recoverable

In no case shall the amount recoverable under this section exceed the price at which the security was offered to the public.

Section 10b of the Securities Exchange Act of 1934

§ **78j.** ***Manipulative and deceptive devices***

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—

> (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Code of Federal Regulations

Title 17

Rule 10b-5

§ 240.10b-5 ***Employment of manipulative and deceptive devices.***

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security.